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Weekly Commentary, Selected Financial Data, and Business Indicators

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Despite The New Year . . .

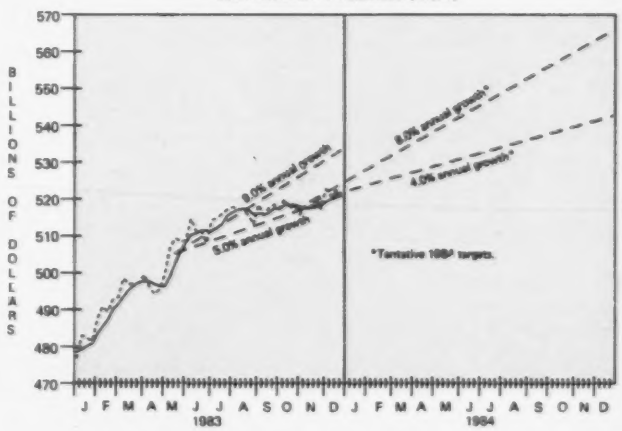
Despite the onset of a new year, some things never change. One of them is the unending speculation as to the direction of Federal Reserve monetary policy and interest rates. For while such recent signs of a moderating pace of business activity as November's dip in the index of leading economic indicators and the "flash" estimate of fourth quarter real gross national product growth have briefly dampened fears of a firming of monetary policy, this welcome interlude may last only as long as the next report on retail sales and industrial production.

For better or worse, market participants continue to ignore a wide variety of factors which suggests that both monetary policy and interest rates will hold basically steady in early 1984. And while a slowing of growth, modest rates of inflation and well-behaved money supply numbers should nudge interest rates slightly lower, prospects for either a significant rate drop or another upward spiral appear equally unfounded.

Take, for example, the likelihood of a free-fall in interest rates. For this to happen, either one of two things, or both, would have to occur: namely, accumulating evidence of a renewed recession just around the corner, and a subsequent easing of the monetary reins to forestall just such an occurrence. With business bankruptcies still running at near-record highs, almost 9¼ million people still unemployed and liquidity strains still affecting some developing countries, the Fed simply could not sit by and allow another recession to develop. But while such a one-two punch of imminent recession and aggressive easing would undoubtedly deflate today's lofty pattern of interest rates, neither seems likely. With consumer confidence now standing at a five-year high, factory orders bulging, inventories being replenished and industrial production rising as a result, the required ingredients for renewed recession are just not in sight—notwithstanding the flattening of M1 money growth since last summer.

To be sure, the pace of business activity is decelerating. But rather than signaling another recession, this development should be precisely what the credit markets are looking for. As the stimulative effect of the initial burst of consumer spending on such items as homes and autos tapers off, and the swing in inventories from liquidation to accumulation provides less of an uplift to business activity, growth settles into a slower, albeit more sustainable pace—typical of the second year of recovery. To ease the monetary reins substantially in this environment would only run the risk of overheating the economy, hastening the long-awaited clash between public and private borrowings and reigniting inflation expectations.

MONEY SUPPLY, M1
FOUR-WEEK MOVING AVERAGE (LINE)
VS. WEEKLY FIGURES (DOT)



. . . Few Changes Appear In Store . . .

As long as the business recovery remains solidly on track, prospects for an overt shift toward monetary ease and a sharp tumble in interest rates appear distant. However, despite frequent observations that the Fed has, or is about to step hard on the money and credit brakes, the likelihood of another upward spiral in rates seems even more distant.

For one thing, to allow this to occur would partially erode the already substantial gains made by several developing countries in restoring external financial health. For another, at a time when the Fed finds its twin nemeses of inflation and ill-behaved money supply numbers at least dormant, if not entirely vanquished, there is simply no need for an abrupt

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